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September 4, 2001

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Salas
Secretary
Federal Communications Commission
Room TW-A325, The Portals
445 Twelfth Street, S. W.
Washington, DC 20554

RE: In the Matter of Applications for Consent to the Transfer of Control of Licenses and
Section 214 Authorizations from Ameritech Corporation, Transferor, To SBC
Communications, Inc., Transferee,
(CC Docket No. 98-141)

Dear Ms. Salas:

Pursuant to Appendix C (Separate Affiliate Requirements) regarding SBC Communications Inc.'s (SBC) compliance with the SBC/Ameritech Merger Conditions, SBC submits herein the report of its independent auditor, Ernst & Young LLP (EY). EY reports on the procedures agreed to by management of SBC and the Federal Communications Commission (FCC) covering the period January 1, 2000 through December 31, 2000.

Pursuant to 47 C.F.R. § 0.459, under separate transmittal, SBC requests confidential treatment of certain proprietary commercial and financial information contained in the report. A copy of the redacted report is attached.

Once SBC has had an opportunity to thoroughly conduct a review of this report and the auditor's work papers, SBC will be prepared to respond to or otherwise address any issues contained in them.

Sincerely,

A handwritten signature in cursive script, appearing to read "Sandra L. Wagner".

Attachments

cc: Ms. Carol Matthey
Mr. Anthony Dale
Mr. Hugh Boyle
Mr. Mark Stephens

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SBC Communications Inc.

**Report of Independent Accountants on
Applying Agreed-Upon Procedures**

September 1, 2001

Report of Independent Accountants on Applying Agreed-Upon Procedures

To the Management of SBC Communications Inc.

We have performed the procedures enumerated in Appendix A, which were agreed to by management of SBC Communications Inc. ("SBC") and the Federal Communications Commission ("FCC"), solely to assist these specified parties in evaluating management's assertion that SBC complied with the separate affiliate requirements set forth in Section I of Appendix C of the FCC's Order approving the SBC/Ameritech Merger, CC Docket No. 98-141, released October 8, 1999 ("Separate Affiliate Requirements"), as amended by the Second Memorandum Opinion and Order, FCC 00-336, released September 8, 2000, allowing SBC's incumbent local exchange carriers ("ILECs") to own certain equipment used to provide Advanced Services throughout SBC's service area, during the period from January 1, 2000 to December 31, 2000 ("the Engagement Period"). This agreed-upon procedures engagement was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described in Appendix A either for the purpose for which this report has been requested or for any other purpose.

The procedures performed for the Engagement Period and the results obtained are documented in Appendix A. These procedures and the results are not intended to be an interpretation of any legal or regulatory rules, regulations or requirements.

On August 16, 2001, the FCC Staff issued a letter extending the due date from September 4, 2001 to November 1, 2001 for completing certain procedures agreed to by the Users related to Southwestern Bell Communications Services, Inc. ("SBCS"). As discussed in Appendix B, definition of an Advanced Services affiliate, the Users agreed that no specific procedures will be performed for SBCS other than the execution of management representation letters by SBCS and the SBC ILECs for the Engagement Period. A separate supplemental report will be issued upon completion of this procedure.

We were not engaged to, and did not, conduct an examination, the objective of which would be the expression of an opinion on SBC's compliance with the Separate Affiliate Requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

To the Management of SBC Communications Inc.

This report is intended solely for the information and use of management of SBC and the FCC and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Ernst & Young LLP

September 1, 2001

APPENDIX A

Results of Agreed-Upon Procedures

The definitions of the following terms are documented in Appendix B: Advanced Services, Advanced Services affiliate(s), ASI, AADS, Advanced Services Equipment, Affiliate, Ameritech States, Assets, Customer Care, Engagement Period, ILECs, Merger Closing Date, Merger Conditions, Official Services, Permitted Billing and Collection Services, SBC States, Users and Voice Grade Services.

Objective I. Determine whether the Advanced Services affiliate(s) has operated independently of SBC's Incumbent Local Exchange Carriers ("ILECs").

1. Inspected the certificates of incorporation and bylaws of the Advanced Services affiliates and noted that the inspected documents stated that each Advanced Services affiliate was established as a Delaware corporation separate from the ILECs. SBC represented that Delaware corporations are not required to file articles of incorporation, and as such, no articles of incorporation exist. No changes in these documents were noted from the prior year.
2. Based on inspection and SBC representation, noted that there were no meetings of the Board of Directors of ASI and AADS during the Engagement Period, and therefore no minutes were prepared. For the Engagement Period, inspected the written consents of the Board of Directors and stockholders of ASI and noted that the documents did not indicate that the ILECs had ownership in the Advanced Services affiliate. Inspected one written consent of stockholders for Ameritech Advanced Data Services of Illinois, Inc. for the Engagement Period and noted that it did not indicate any ILEC ownership in the Advanced Services affiliates. Noted by inquiry and SBC representation that AADS had no other written consents during the Engagement Period.
3. Obtained and inspected the SBC corporate organizational charts as of December 29, 2000 and confirmed with legal representatives of the ILECs and Advanced Services affiliates the legal, reporting and operational corporate structure of the Advanced Services affiliates. Based on inspection of the organizational charts and confirmation with legal representatives, noted that the Advanced Services affiliates were independent from the ILECs.

Based on the review of documentation obtained above, noted that as of the end of the Engagement Period, ASI was 92.52% owned directly by SBC Communications Inc., 6.72% owned by Southern New England Telecommunications Corporation and 0.76% owned by Pacific Telesis Group.

Southern New England Telecommunications Corporation and Pacific Telesis Group were both 100% owned subsidiaries of SBC Communications Inc. ASI organizationally reported to SBC Communications, Inc., Southern New England Telecommunications Corporation and Pacific Telesis Group.

Also noted that as of the end of the Engagement Period, each of the AADS Advanced Services affiliates was 100% owned by Ameritech Corporation, which in turn was 100% owned by SBC Communications Inc. Management of AADS reported directly to the president of ASI.

4. Obtained a functional organizational chart for each Advanced Services affiliate as of the end of the Engagement Period and obtained SBC's documentation for each department of the number of employees, street addresses where employees were located and description of functions performed by location. See Attachments A-1-A and A-1-B.

As of the end of the Engagement Period, noted that the documentation obtained stated that ASI employed people, all located throughout the SBC States. The ASI employee classifications are documented in Attachment A-1-A.

As of the end of the Engagement Period, noted that the documentation obtained stated that AADS employed people, all located throughout the Ameritech States. The AADS employee classifications are documented in Attachment A-1-B.

5. Obtained from the Advanced Services affiliates a list and description of services rendered to each Advanced Services affiliate by the ILECs and other affiliates during the Engagement Period.

A listing of the services provided by each ILEC to the Advanced Services affiliates through all agreements is included at Attachment A-2. A description of each of the affiliate agreements is located on the Internet at:

<http://www.sbc.com/PublicAffairs/PublicPolicy/Regulatory>

Additionally, the following is a listing, obtained from the ASI and AADS, of the services provided by affiliates other than the ILECs to the Advanced Services affiliates:

Table 1

Affiliate	Advanced Services Affiliate	Service(s) Provided
SBC Services, Inc.	ASI	<ul style="list-style-type: none"> • Financial Services • Payroll • Billing Services • Training • Human Resources • Information Technology • Internal Communication Services • Network Services • Procurement • Corporate Real Estate Management
SBC Services, Inc.	AADS	<ul style="list-style-type: none"> • Financial Services • Information Technology • Payroll • Procurement
Ameritech Corporation	AADS	<ul style="list-style-type: none"> • Financial Services • Human Resources • Legal Services
SBC Management Services, Inc.	ASI & AADS	<ul style="list-style-type: none"> • Management and Administrative Functions
SBC Operations, Inc.	ASI & AADS	<ul style="list-style-type: none"> • Marketing & Product Development • Broadband (Project Pronto) Planning (ASI only)
SBC Technology Resources, Inc.	ASI & AADS	<ul style="list-style-type: none"> • Technological Research and Development
Southern New England Telecommunications Corporation	ASI	<ul style="list-style-type: none"> • External Affairs/Customer Appeals • Marketing • Real Estate Management • Temporary Projects • Training

Affiliate	Advanced Services Affiliate	Service(s) Provided
Ameritech Communications, Inc.	AADS	<ul style="list-style-type: none"> • Interexchange Carrier Support, and InterLATA Voice Services Outside of SBC States
Ameritech Credit Corporation	AADS	<ul style="list-style-type: none"> • Lease Financing
Ameritech Interactive Media Services	AADS	<ul style="list-style-type: none"> • Joint Marketing
Clover Technologies	AADS	<ul style="list-style-type: none"> • Material and Equipment
Cingular Wireless	ASI & AADS	<ul style="list-style-type: none"> • Wireless Telephone Services
Security Link	AADS	<ul style="list-style-type: none"> • Security Services

6. Obtained from ASI a list and description of any Network Planning, Engineering, Design and Assignment services rendered by unaffiliated entities on or after April 5, 2000, and noted that an unaffiliated entity performed design and installation for Customer Premises Native Local Area Network ("LAN") and Virtual Point of Presence-Circuit Emulation Services ("VPOP-CES") on behalf of ASI in California. Otherwise, the list indicated that no unaffiliated entities provided any Network Planning, Engineering, Design and Assignment services to ASI on or after April 5, 2000.

SBC represented that AADS did not obtain any Network Planning, Engineering, Design and Assignment services from an unaffiliated entity on or after April 5, 2000.

7. Performed the following:
- Obtained the balance sheet as of the end of the Engagement Period for each Advanced Services affiliate.
 - Obtained the listings of all fixed assets account balances, including capitalized software ("summary listings"), that rolled forward from the prior year's balance by adding additions, transfers in, transfers out and other retirements. Compared the amount shown on the summary listings with the amount shown in the balance sheets and noted the variances below:

Noted for ASI that the general ledger balance was \$ [redacted] less than the summary listing as of the end of the Engagement Period. SBC explained that the variance is due to the extracting of information from the perpetual accounts payable, accrual and fixed asset systems. This amount is not reconcilable as the information used to produce the rollforward was derived from multiple perpetual tracking systems. As there are constant updates to these systems, the exact data as it existed at the closing of the Engagement Period is not obtainable. Consequently variances of the detail records totals as compared to the closing total reported in the general ledger exist.

Noted for AADS no variance between the balance sheet and the summary listing as of the end of the Engagement Period.

- c. Obtained the detailed fixed assets listings ("detailed listings") of each Advanced Services affiliate that showed the cumulative adds (i.e., additions and transfers in) for the Engagement Period. Noted that the detailed listings included, for each asset, description, location, date of purchase or transfer and price paid and recorded, and whether it was acquired from an ILEC, affiliate or nonaffiliate. Obtained a reconciliation of the total additions and transfers in for each account to the additions and transfers in appearing on the summary listings obtained in step (b) above and noted the following reconciling differences:

Noted that the detailed listings from ASI had an unreconcilable difference of \$ [redacted]. SBC has represented that the difference was an unreconcilable variance.

Noted that the detailed listings from AADS had a net reconciling difference of \$ [redacted]. SBC explained that the difference included \$ [redacted] of fixed assets placed into the accounting system in 1999, but not recorded in the general ledger until 2000. This difference was offset by a \$ [redacted] adjustment recorded to correct errors in account balances caused by problems with the accounting system, a \$ [redacted] adjustment for the retirement and transfer of certain assets to ASI and \$ [redacted] in miscellaneous adjustments. After consideration of the above items, AADS had an unreconcilable variance of \$ [redacted].

- d. From the listings obtained in the previous procedure, randomly selected 100 items, excluding capitalized labor and Allowance for Funds Used During Construction ("AFUDC"). For each item selected, inspected supporting documentation that revealed ownership. Noted no instance where the items selected were jointly owned with the ILECs or any other affiliates.

Objective II. Determine whether the separate Advanced Services affiliate has maintained books, records and accounts in the manner prescribed by the Commission that are separate from the books, records and accounts maintained by the ILECs.

1. Obtained the general ledger of each Advanced Services affiliate as of December 31, 2000 and matched the title on the G/L with the name of the affiliate on the certificate of incorporation and noted that a separate G/L was maintained. Reviewed the general ledgers for special codes to link the Advanced Services affiliates' general ledgers to the general ledgers of the ILECs and noted none.
2. Documented the accounting procedures and policies utilized by each Advanced Services affiliate during the Engagement Period. This documentation includes the practitioners' understanding of the accounting systems, processes, transaction flows and control points affecting revenue, accounts receivable, cash receipts, purchasing, accounts payable, cash disbursements, payroll, fixed assets and recording of affiliate transactions.

Noted that ASI maintained a separate general ledger from the ILECs and continued to obtain accounting support from SBC Services, Inc. SBC Services, Inc. establishes accounting policies and procedures for most SBC affiliates (including ASI) and maintains ASI's general ledger and other financial accounting systems under an affiliate agreement. These accounting systems include billing and collections, purchasing, accounts payable, cash disbursements, payroll and fixed assets. ASI follows the accounting practices used by the other non-ILEC SBC Wireline companies. Noted that ASI does not maintain any written accounting procedures and policies.

Obtained the Ameritech Legal Entity Financial Operations Guide that contains documentation of AADS's accounting procedures and policies. Noted that AADS maintained a separate general ledger from the ILECs and obtained general ledger accounting, accounts payable, purchasing and payroll processing from Ameritech Services, Inc. Noted through review of supporting documentation and inquiry that AADS maintained its own revenue and accounts receivable system. Cash remittance operations were outsourced to Ameritech Information Systems, Inc., while actual cash management and cash disbursements were performed by Ameritech Services, Inc.

Noted that there is an internal control for properly identifying and recording Advanced Services affiliate transactions which included the existence of the Affiliate Oversight Group. This group oversees all affiliate transactions and requires that they be accounted for in accordance with the applicable FCC rules.

Noted per review of supporting documentation that SBC has formalized its accounting procedures and policies in a set of Operating Procedures ("OPs"). Section 10.502 of OP 6 includes a description of the requirements and restrictions

applicable to transactions with the Advanced Services affiliates as specified in Section 272 of the Telecommunications Act of 1996 ("Section 272"). As any procurement activity by an ILEC from an Advanced Services affiliate would result in an affiliate transaction, OP 6 refers to OP 125 – *"Nontariffed Activities and Affiliate Transactions,"* for complete instructions on affiliate transactions. The company has established written controls to require that any ILEC purchase from an Advanced Services affiliate comply with Section 272, including the ILECs' nondiscriminatory procurement obligations. Noted that OP 6 contains procedures requiring any nontariffed affiliate transaction, including an ILEC procurement from an Advanced Services affiliate, to be approved by the Affiliate Oversight Group, prior to the purchase, and the approval process includes a review of the ILECs' nondiscrimination obligations.

3. Performed one walk-through at each Advanced Services affiliate of a cash receipt, cash disbursement and payroll transaction and noted the transactions were appropriately reflected in the general ledger of each Advanced Services affiliate. An audit trail of each walk-through and a copy of the transaction have been included in the workpapers.
4. Obtained each Advanced Services affiliate's financial statements as of the end of the Engagement Period and a listing of all lease agreements, including the associated annualized payments or receipts in effect during the Engagement Period. Identified, in the workpapers only, those leases for which the annual payments or receipts are \$500,000 or more. Obtained copies of the leases that met this criteria and noted whether the leases had been accounted for in accordance with Generally Accepted Accounting Principles ("GAAP"). Noted the following for each Advanced Services affiliate:

Obtained copies of ASI leases with annual payments or receipts equal to or greater than \$500,000. Judgmentally selected five leases for testing. Noted that the leases selected for testing were appropriately recorded as operating leases in accordance with GAAP. Also, obtained and reviewed a memo from ASI that provided an overview of the affiliate's lease accounting policies, and noted that such policies were in accordance with GAAP.

Obtained copies of AADS leases with annual payments equal to or greater than \$500,000. Noted that there were no leases with receipts equal to or greater than \$500,000. There were three leases with annual payments equal to or greater than \$500,000. Noted that the leases selected for testing were appropriately recorded as operating leases in accordance with GAAP. Also, obtained and reviewed a memo from AADS that provided an overview of the affiliate's lease accounting policies, and noted that such policies were in accordance with GAAP.

Objective III. Determine whether the separate Advanced Services affiliate has officers, directors and employees that are separate from those of the ILECs.

1. Obtained the ILECs' and Advanced Services affiliates' policies and procedures for transferring, sharing and loaning employees between each other and identified and documented the types of internal controls that were in place during the Engagement Period to prevent one from being an officer, or director, or employee of both the ILECs and the Advanced Services affiliates at the same time. The policies and procedures provided by SBC are noted below:

Transfers

Noted that policies and procedures for employee transfers are specified in the business rules for recording employee status events in the payroll systems. These procedures require any employee "status changing" event, including movement or transfer between affiliates, to be documented by a Personnel Change Record ("PCR") form. This form requires that the payroll charging direction for a transferred employee be redirected to the "receiving" subsidiary. The rules specifically advise that PCRs must be processed timely to provide that a transferred employee does not receive a paycheck from both a former and a new subsidiary.

Noted that SBC also has an automated approach to detect any errors which may occur if PCRs are not processed timely or correctly. The SBC Human Resources Organization Service Center generates a weekly report that compares the social security numbers for all employees in the four payroll systems in use in SBC during the Engagement Period. This report is designed to compare the systems in order to verify that no employee is receiving pay from more than one subsidiary within the four payroll systems.

Sharing & Loan of Employees

Noted that SBC policy prohibits the provision of any good or service between the ILECs and affiliates that does not follow the FCC's Accounting Safeguard rules. Also noted that the sharing and loan of employees not properly documented with a written agreement and compensated according to the FCC's requirements would be prohibited by SBC policy. Noted that the SBC policy defines that any service provided by employees of either the ILECs or the Advanced Services affiliates to the other would be deemed an affiliate transaction and is required to be structured under the provisions of OP 125 (described in response to Objectives V & VI, Procedure 2).

Officers/Directors

Noted that SBC's policy defines officers as any individual that has been designated to hold a corporate office that has been authorized by the ILEC/Advanced Services affiliates (collectively referred to as "subsidiaries") bylaws. Officers and directors are not required to be employees of the

subsidiary. Noted that the policies, procedures and internal controls for officers and directors are similar.

Noted that the internal control to prevent one from being an officer or director of both an ILEC and Advanced Services affiliate is the manual review of each entity's board and officer listings prior to effecting a change to the board of directors or officers of an affiliate. All subsidiary corporate memberships (directors and officers) are managed centrally through SBC's Legal Department. The Legal Department is assigned to review all changes in the composition of the ILECs and Advanced Services affiliates for individuals simultaneously active at both an ILEC and Advanced Services affiliate.

Employees

Noted that there is an internal control to detect and prevent an employee's "dual employment" with the ILECs and the Advanced Services affiliates which includes the company's payroll systems' built-in controls which prevent an employee from being carried on multiple affiliate payrolls within the same payroll system. Noted that although the company has multiple payroll systems, employees continue to be paid through their original payroll system, regardless of which affiliate they subsequently transfer to. The current employing affiliate always recognizes the employee's payroll expense.

In addition, also noted that supplemental controls include paycheck/advice distribution through the employee's supervisor (or designate), rather than directly from the payroll organization to the employee.

2. Inquired of the Company and documented that the Advanced Services affiliates and the ILECs maintain separate boards of directors and separate officers. Obtained a list of officers' and directors' names, including the dates of service for each officer and/or board member, for the ILECs and Advanced Services affiliates for the Engagement Period. Compared the lists and documented one instance where an officer of ASI was also listed as an officer of Pacific Bell during the Engagement Period. Inquired and noted that the officer resigned from Pacific Bell effective July 1, 2000 and became an officer of ASI on July 10, 2000.

Read the minutes of the meetings of the board of directors and written consents of the stockholders electing the board of directors for each ILEC and the written consents of the Advanced Services affiliates for the Engagement Period and compared and documented the names appearing on the minutes and consents of the ILECs and Advanced Services affiliates. Noted no individuals served as a director or officer of an ILEC and an Advanced Services affiliate simultaneously.

3. Obtained the functional organizational chart for each Advanced Services affiliate as of the end of the Engagement Period. Inspected them and noted no departments reporting either functionally or administratively (directly or indirectly) to an officer of the ILECs.
4. Obtained files containing the year-to-date payroll information for each Advanced Services affiliate and each ILEC that included the social security numbers of all the directors, officers and employees as of the end of the Engagement Period. Using the files obtained, compared social security numbers of directors, officers and employees and prepared a list of those appearing on both the Advanced Services affiliates' payroll and the ILECs' payroll. For a random sample of 25 employees appearing on the list, obtained detailed payroll records to verify that they had not been simultaneously on both an ILEC's and an Advanced Services affiliate's payroll at any time during the Engagement Period. Documented, in the workpapers only, those names and/or social security numbers appearing on both payrolls. For any employee appearing on both payrolls, inquired and documented that, in each case, the employee transferred from one entity to another. Based on review of the detailed payroll records, at no time during the Engagement Period was an employee simultaneously on both an ILEC's and an Advanced Services affiliate's payroll.
5. Obtained a list of all employees, including officers, who transferred from an ILEC to an Advanced Services affiliate at any time during the Engagement Period. Noted that the company's internal controls (documented in Objective III, Procedure 1) had been implemented by examining supporting documentation (payroll records) for a random sample of 25 transferred employees from the total population of transferred employees. Obtained written confirmation from 23 transferred employees selected for testing, and noted that they had received training on the use of proprietary information. Two selected employees were no longer employed by SBC and could not be confirmed.

Objective IV. Determine that the Advanced Services affiliate has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the ILECs.

1. Documented, in the workpapers, that the Advanced Services affiliates had no debt agreements/instruments or credit arrangements with unaffiliated lenders or major suppliers of goods and services in effect during the Engagement Period.

SBC Communications Inc. and Ameritech Corporation, the "holding companies," extended credit to the Advanced Services affiliates through the consolidated cash management process.

Documented that the leases of the Advanced Services affiliates included no guarantees or recourse to the ILECs' assets either directly or indirectly through the consolidated cash management process.

2. Using the lease agreements obtained in Objective II, Procedure 4 (those exceeding \$500,000), documented that there were no instances in which an Advanced Services affiliate's lease agreement had recourse to the ILECs' assets either directly or indirectly through another affiliate.

Also reviewed the listing of Advanced Services employee work locations obtained in Objective II, Procedure 4 and noted that the Advanced Services affiliates' employee work locations were either covered under a lease agreement or owned outright by one of the Advanced Services affiliates, except for the following 59 locations:

- 15 locations were covered under affiliate agreements with the ILECs.
- 7 locations were covered under affiliate agreements with other affiliates.
- 10 locations were employees who worked from home.
- 6 locations were leased by SBC Services, Inc. but not covered by an affiliate agreement with ASI.
- 15 locations were incorrectly designated as employee work locations.
- 6 locations were ILEC facilities with no affiliate agreements in place between ASI and the ILEC.

3. Requested positive written confirmation from the Advanced Services affiliates' lessors for all leases with annual payments in excess of \$500,000 and for 10 leases judgmentally selected with annual payments less than \$500,000. Received responses from 24 out of the 28 requests sent; the responses confirmed that there was no recourse either directly or indirectly to the assets of any of the ILECs.

As documented in Objective IV, Procedure 1, noted that the Advanced Services affiliates had no debt agreements/instruments or credit arrangements with unaffiliated lenders or major suppliers during the Engagement Period.

4. Obtained documentation and noted the balance of accounts payable to and/or advances from the ILECs as of the end of the Engagement Period for each Advanced Services affiliate.

AADS's and ASI's net payable (receivable) balances to (from) the ILECs at December 31, 2000 were as follows:

Table 2

	<u>AADS</u>	<u>ASI</u>
Ameritech Illinois		
Ameritech Indiana		
Ameritech Ohio		
Ameritech Michigan		
Ameritech Wisconsin		
SWBT		
SNET		
Pacific Bell		
Nevada Bell		
Total payable to ILECs		

Objective V. Determine whether the Advanced Services affiliate has conducted all transactions with the ILECs on an arm's length basis with the transactions reduced to writing and available for public inspection.

Objective VI. Determine whether or not the ILECs have accounted for all transactions with the separate Advanced Services affiliate in accordance with the accounting principles and rules approved by the FCC.

1. Documented, as follows, the procedures used by the ILECs and the Corporate Compliance Officer to identify, track, respond and take corrective action to competitors' complaints relating to alleged noncompliance with the Advanced Services provisions of the Merger Conditions.

SBC represented that the following procedures were used by the ILECs and the Corporate Compliance Officer to identify, track and respond to complaints relating to alleged noncompliance with the Advanced Services provisions of the Merger Conditions during the Engagement Period. The SBC Compliance Officer directed each business unit officer responsible for compliance with the Merger Conditions to refer any complaints or inquiries regarding merger compliance to the Executive Director-FCC Merger Compliance. This directive was delivered numerous times on weekly conference calls with the business unit officers to discuss the status of compliance with the Merger Conditions. The Executive Director-FCC Merger Compliance's responsibility was to require that a listing of all complaints be maintained, that all complaints be acknowledged and investigated with appropriate input from Legal and the affected business unit and that the resolution be documented. If complaints were found to be related to the Merger Conditions, the Executive Director-FCC Merger Compliance reported the complaint to the Corporate Compliance Officer.

Obtained from the ILECs and the Corporate Compliance Officer a list of all FCC formal complaints, as defined in 47 CFR 1.720; FCC informal complaints, as defined in 47 CFR 1.716; and any written complaints made to a state regulatory commission from competitors filed during the Engagement Period involving alleged noncompliance with the Advanced Services provisions of the Merger Conditions, including complaints submitted by competitors related to the provision or procurement of goods, services, facilities and information, or in connection with the establishment of standards. Noted eight complaints filed during the Engagement Period. Of the eight complaints, documented below, two remain open while SBC considers six to have been resolved.

- Allegations of cross-subsidies (*no complaints received*)
- Allegations of discriminatory provision or procurement of goods, services, facilities or customer network services information (excludes

customer proprietary network information ("CPNT")) or the establishment of standards (*no complaints received*)

- Allegations of discriminatory processing of orders for, and provisioning of, unbundled network elements ("UNEs"), and discriminatory resolution of network problems (*two complaints received*)

1. On April 18, 2000 Omniplex Communications sent letters to the Texas Public Utility Commission ("PUC") and the FCC claiming that SBC was avoiding taking orders or providing a contact for resale of Advanced Services and that SBC was improperly requiring Omniplex Communications to become a UNE provider. After receipt of the complaint the SBC account team advised Omniplex Communications that it could order Advanced Services on a "business as usual" basis through the local service center until further notification. On May 11, 2000, SBC sent a final response letter that reinforced SBC's position on the issue of ordering "resale" ADSL service via the Local Service Center ("LSC"). On the UNE issue, SBC's final response rebutted the allegations, emphasizing that the Missouri agreement was not approved by the PUC and effective until April 17, 2000 and that there had been a substantial delay in Omniplex Communications obtaining certification as a facilities based CLEC. No further complaints from Omniplex Communications have been received since SBC's response on May 11, 2000, and this complaint is considered closed by SBC.

2. In a letter dated November 8, 2000, EarthLink filed a complaint against SBC with the FCC. The complaint alleged that SBC was provisioning DSL to favor unlawfully its affiliated and/or preferred ISPs. EarthLink claimed that it had to wait longer than SBC's affiliates for provisioning of DSL orders and that SBC was engaging in anti-competitive, discriminatory and unreasonable marketing practices. SBC replied to the FCC on December 13, 2000 rebutting EarthLink's allegations. This issue remained open as of the end of the Engagement Period.

- Allegations of discriminatory availability of unbundled network elements (*one complaint received*)

1. Premier Network Services contacted the FCC on February 24, 2000 and stated that it believed the SBC/Ameritech Merger Conditions, together with the expired AT&T/Pacific Bell contract in California, required SBC to provide UNE combinations that

were not mandatory under the Iowa Utilities Board cases or the FCC's UNE Remand Order. On March 2, 2000 SBC responded, advising that SBC's review of the Merger Conditions and the Iowa Utilities Board decision concluded that Premier Network Services' requested UNE combination was not mandatory and that SBC could not accommodate Premier Network Services' request. After additional correspondence Premier Network Services called the FCC regarding SBC's positions and asked that the FCC look into the issue. The FCC has not initiated any action, and as a result, this complaint is considered closed by SBC.

- Allegations of discriminatory availability of facilities or services not at the same rates and not on the same terms and conditions as the separate Advanced Services affiliates (*four complaints received*)
 1. Covad sent a letter to the FCC on February 10, 2000 stating that it believed that SBC was required to make available rates for xDSL loop conditioning services that were contained in any effective SBC Interconnection Agreement. On March 21, 2000 SBC informed Covad that SBC was ready to provide rates from any effective Interconnection Agreement. SBC represented that there were no additional contacts related to this complaint from Covad. This inquiry is considered closed by SBC.
 2. On September 29, 2000 CompTel wrote the FCC with a series of seven questions relating to the Accessible Letter (CLEC00-171) offering Broadband Service and its alleged contradictions with the FCC's Pronto Modification Order. SBC responded to the inquiry on October 13, 2000 in writing to the FCC by clarifying misunderstandings by CompTel regarding SBC's Voluntary Conditions and its Accessible Letter. SBC proposed modified language to some of the terms of the Accessible Letter to clarify those terms. On October 10, 2000 CompTel filed a petition for reconsideration in CC Docket No. 98-141 with the FCC. This item was closed on May 4, 2001 when CompTel withdrew its petition for reconsideration in CC Docket No. 98-141.
 3. On October 13, 2000, the Common Carrier Bureau of the FCC voiced concerns via a letter to SBC regarding SBC's interpretation of the provision that allowed SBC's ILECs to perform network planning, engineering, design and assignment of services on behalf of SBC's Advanced Services affiliate for a limited period of time during the 180 day transition period after the Merger Closing Date. SBC responded to the FCC inquiry via letter on November 13, 2000, and addressed the questions raised by the FCC regarding

SBC's interpretation of the Merger Conditions in the SBC/Ameritech Merger Order. SBC refuted the FCC's position citing subparagraphs I (3)(C)(3) and I (4)(N) to the Merger Conditions. This inquiry is considered closed by SBC.

4. In a letter dated October 3, 2000, @Link Networks filed a complaint with the FCC alleging that SBC and its affiliates interfered with and undermined the ability of @Link Networks to roll out DSL services consistent with the statutory and policy goals of reasonable, timely and affordable deployment of Advanced Services. SBC represented that it met with @Link Networks on November 11 and December 12, 2000 to discuss modified acceptance testing, virtual collocation, installation of @Link Networks remote test equipment and other issues related to Interconnection Agreements. This issue remained open as of the end of the Engagement Period.

SBC had one complaint that was received that could not be categorized in any one of the categories above:

WorldCom, Inc. wrote a letter to the FCC on November 3, 2000 requesting assessment of fines to SBC for issues noted in the 1999 Agreed-Upon Procedures engagement. The request was based upon the WorldCom, Inc. review of the Ernst & Young Report submitted to the FCC on September 1, 2000. WorldCom, Inc. requested that the FCC undertake a full investigation into SBC's compliance with the Merger Order and impose sanctions for each violation the FCC discovered. The FCC has not initiated any action, and as a result, this complaint is considered closed by SBC.

2. Obtained from the ILECs and each Advanced Services affiliate current written procedures for transactions with affiliates and compared these procedures with the FCC Rules and Regulations, including Sections 32.27, 53.203(e) and 64.901; Paras. 122, 137, 183 and 265 of the *Report and Order* in CC Docket No. 96-150, issued December 24, 1996, concerning Accounting Safeguards Under the Telecommunications Act of 1996 (11 FCC Rcd 17539 (1996)); Paras. 180, 193 and 218 of the *First Report and Order and Further Notice of Proposed Rulemaking* in CC Docket No. 96-149, issued December 24, 1996, concerning Non-Accounting Safeguards under Sections 271 and 272 of the Telecommunications Act of 1996; and Para. 337 of the *Memorandum Opinion and Order* in CC Docket No. 98-121, issued October 13, 1998, concerning BellSouth's 271 application in Louisiana. Noted no exceptions.
3. Inquired and documented how the ILECs and each Advanced Services affiliate disseminate the FCC Rules and Regulations and conditions of the Merger Agreement by noting that the SBC Merger Compliance Group ("MCG"),

operating at the parent company level, has overall responsibility to coordinate dissemination of the obligations created by the Merger Conditions across the entire company including both the ILECs and the Advanced Services affiliates. At the corporate level, SBC represented that the MCG established an interactive Intranet-based training course and posted various training material on an Intranet site. SBC represented that the MCG has designated a training coordinator for each impacted business unit. In addition, SBC represented that the MCG presented Merger Compliance training in association with existing company-wide training developed to address the requirements created by Section 272.

The following types and frequency of training were noted:

ILECs:

SBC represented that the training provided by the ILECs addressed key topics such as what services could be provided to ASI, the required terms and conditions for providing services, the protection of proprietary information and permitted and prohibited activities when performing joint marketing. Managers were provided with training on general merger issues, including merger impacts, dates, conditions, public interest and goals of the merger, and how to handle inquiries about the merger. The line managers then conducted training with front-line employees on general merger issues to provide an understanding of how the merger impacted their jobs and how to achieve and maintain compliance.

SBC represented that the ILECs developed numerous documents containing the Methods and Procedures ("M&P") associated with the transition of Advanced Services to the Advanced Services affiliates and subsequent "Steady State" operations. M&P were a primary training tool to require that employees performed specific business procedures in compliance with the Merger Conditions.

In addition, SBC represented that employees of the ILECs and the Advanced Services affiliates attended training presented by the MCG. The MCG incorporated the requirements of Section 272 applicable to the Advanced Services affiliates into the Section 272 Compliance Program. This training was presented in live sessions at various company locations in 2000.

SBC represented that the MCG also made training materials available to employees of the ILECs and Advanced Services affiliates via the Intranet. SBC maintained an Intranet site with various training materials and on-line courses available to all employees.

SBC represented that frequency of the training was focused on transition activities and initial training on steady-state requirements, as 2000 was the first full year the Merger Conditions were applicable. SBC represented that frequency of refresher training will be determined in 2001.

Advanced Services affiliates:

SBC represented that at the beginning of the Engagement Period, the Vice President and General Legal Counsel for the Advanced Services affiliates conducted specific training on Merger Conditions compliance. This training included instructions regarding Section 272 of the Telecommunications Act of 1996, Advanced Services, joint marketing, line sharing provisions, the Merger Conditions and SBC's Code of Business Conduct. During the 2000 Engagement Period, responsibility for Merger Awareness training was transitioned to the training department created within the Advanced Services affiliates' Human Resources Department. The Advanced Services affiliates' Human Resources organization created the ASI/AADS Employee Training Path, which was a Web-based employee-training path created for Advanced Services affiliate employees. The initial training path for each job function/description includes a compliance curriculum that requires employees to complete specific merger-related training courses.

The Advanced Services affiliates were designed and organized to be structurally separate from the ILECs. Separate operating procedures were developed for the Advanced Services affiliates' business activities, and these procedures specifically addressed the restrictions and requirements on interaction with the SBC ILECs, as imposed by the Merger Conditions and other FCC rules. SBC represented that M&P at the Advanced Services affiliates were designed pursuant to restrictions and requirements of the Merger Conditions. SBC represented that M&P were a primary training tool to require that employees performed specific business procedures in compliance with the Merger Conditions.

SBC policies related to Merger Conditions:

Code of Business Conduct

SBC represented that each SBC employee is expected to abide by the standards embodied in the SBC Code of Business Conduct. Toward this objective, all employees have the following responsibilities with regard to the Code's administration.

- Ensuring that each employee they supervise annually receives and reads a copy of the Code of Business Conduct and signs a copy of the Acknowledgment Form annually;
- Ensuring that employees are aware that they may make a good faith report of a violation or suspected violation of the law or the Code without fear of reprisals;
- Ensuring that any standards and procedures developed for their areas comply with the Code and are communicated to affected employees;
- Reporting any possible violations of the Code of Business Conduct, situations which could result in Code violations or be perceived as Code violations to higher level management.

SBC represented that the Code of Business Conduct was revised in 2000 to incorporate the Merger Conditions by reference.

Competition Guidelines

SBC represented that the Company's Competition Guidelines are supplemental to the Code of Business Conduct, and employees are required to review the Competition Guidelines every three years (annually in Texas) with the review documented in the employee's record. SBC represented that the Competition Guidelines were revised in 2000 to incorporate the requirements created by the Merger Conditions.

Supervision of employees responsible for ensuring compliance with these rules:

SBC represented that the MCG defined responsibilities for each business unit to name a primary and secondary training contact. SBC represented that the role of the Primary Contact was to provide training for the business unit.

In addition, SBC represented that it also maintains a company-wide Section 272 Compliance Program which includes a designated Compliance Coordinator for each business unit. SBC represented that the Coordinator's responsibilities include training, and the Section 272 training incorporates the compliance requirements imposed by the Merger Conditions.

Interviewed those employees responsible for developing and recording in the books or records of the carrier transactions affected by these rules and noted that they were aware of the Merger Conditions and affiliate transaction rules. These employees included four employees from the Affiliate Oversight Group, three employees from Ameritech Services, Inc. responsible for recording AADS and Ameritech ILEC transactions, two employees from SBC Services, Inc. responsible for recording ASI and SBC ILEC transactions and two employees from ASI responsible for recording ASI transactions.

4. Obtained all written agreements, including all Interconnection Agreements, for services and for equipment/facilities between the ILECs and each Advanced Services affiliate which were in effect during the Engagement Period. Summarized these agreements and/or included copies of relevant pages in the workpapers. Compared these agreements with the list of services provided by the ILECs to the Advanced Services affiliates in Objective I, Procedure 5 and noted no exceptions.

In addition, noted those agreements still in effect, and for those agreements no longer in effect, indicated the termination date. SBC represented that no agreements were terminated prematurely during the Engagement Period because the service agreements between the ILECs and the Advanced Services affiliates

are not term agreements. Inquired and documented that the ILECs' policy is to not provision services to the Advanced Services affiliates without a written agreement. SBC represented that neither of the Advanced Services affiliates obtained any services from an ILEC without a written agreement.

The affiliate agreements in effect as of the end of the Engagement Period are posted on the SBC web site at:

<http://www.sbc.com/PublicAffairs/PublicPolicy/Interconnection>

Written agreements terminated during the Engagement Period are documented at Attachment A-3.

5. Inquired and noted, per review of the Interconnection Agreements obtained in Procedure 4 above, by company that all Interconnection Agreements between the Advanced Services affiliates and the ILECs had been publicly disclosed, including prices, discounts, terms and conditions.

Documented the process used to publicly disclose all Interconnection Agreements and noted that Interconnection Agreements and any subsequent amendments are disclosed when the agreements are filed and approved by the responsible PUC. Noted by reviewing the Interconnection Agreements that the Interconnection Agreements contain the prices, terms, conditions and any discounts applicable to services provided by the ILECs to the Advanced Services affiliates. Noted that ASI and AADS had approved Interconnection Agreements with the SBC ILECs in each state where they operated during the Engagement Period. Documented that each state PUC discloses the existence of approved Interconnection Agreements through publicly available listings of approved Agreements of certificated CLECs, and these listings are typically available on the Internet through the PUC's Internet page. Public disclosure of Interconnection Agreements by the State Commissions is required by the Telecommunications Act of 1996. The filed Interconnection Agreements are available to any CLEC or other interested party by request from the applicable State Commission.

6. For the random sample of 50 affiliate agreements and 63 related pricing addendums obtained in Objectives V and VI, Procedure 4, performed the following:
 - a. Viewed the SBC home page (<http://www.sbc.com/PublicAffairs/PublicPolicy>) and compared the prices and terms and conditions of services and assets in the agreements obtained in Objectives V and VI, Procedure 4 to those shown on the web site. Noted no exceptions. By physical inspection, noted that the same information is made available for public inspection at the principal place of business of the ILECs. Noted that SBC did not make any claim of confidentiality for nondisclosure.

- b. Noted by inquiry and observation that these agreements and all related pricing addendums were posted for public inspection within 10 days of their occurrence except for the 65 postings noted in Attachment A-4. Documented that SBC's procedures for posting these agreements and transactions on a timely basis are located on the SBC web site at:

<http://www.sbc.com/PublicAffairs/PublicPolicy/Regulatory/affdocs/MethodsProc-Rev.doc>

- c. Noted that the information provided on the Internet is sufficiently detailed to allow evaluation for compliance with the FCC's accounting rules because entire agreements are posted on the SBC Internet web site. Noted that all the details needed to allow evaluation for compliance with the FCC's accounting rules are made available.

For asset transfers, the agreement reviewed disclosed both the total amount and the unit amount of the asset transferred included in the sample, allowing the calculation of the quantity. For affiliate transactions involving services, noted that the disclosure was sufficiently detailed as described in this procedure.

- d. Obtained copies of the Internet postings for all of the agreements and pricing addendums reviewed.
- 7. Obtained a list and description of all software and/or licenses transferred from the ILECs to the Advanced Services affiliates. Noted and documented that all such transfers were posted with the affiliate agreements on SBC's Internet web site noted in Objectives V and VI, Procedure 4 above.

Transfers were made by SWBT and are located at the following web address:

<http://www.sbc.com/PublicAffairs/PublicPolicy/Regulatory>

- 8. For nontariffed services and for services for which a prevailing market price ("PMP") has not been established, or which are not subject to agreements filed with a public service commission, documented the ILECs' and the Advanced Services affiliates' process for developing fully distributed cost ("FDC"). Documented and identified the type of costs included in FDC and documented SBC's calculation of FDC for two services provided by each ILEC to an Advanced Services affiliate and by each Advanced Services affiliate to an ILEC.